

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Person To Contact:

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Refer Reply To:

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Date:

December 02, 2011

RE:

Legend

Taxpayer

Decedent

Trust

Residuary Trust

Bank

Date 1

Date 2

Date 3

Date 4

State Statute

Attorney

Court

Individual 1

Individual 2

Individual 3

Individual 4

Individual 5

a

b

Dear _____ :

This letter responds to your authorized representative's letter dated June 17, 2011, requesting estate and generation-skipping transfer (GST) tax rulings with respect to the proposed reformation and modification of Trust.

The facts and representations submitted are summarized as follows:

Decedent was married to Taxpayer. Decedent executed Trust on Date 1. Pursuant to the terms of Trust, upon the death of Decedent, Trust becomes irrevocable. Upon the death of Decedent, after payment of claims and debts, the balance of the estate is to be held in trust in accordance with the provisions of Article IV.

Article IV of Trust provides that the largest amount needed to permit Decedent's estate to use Decedent's unified credit shall be held in Residuary Trust and the balance is to be held in the marital trust.

Article IV, paragraph (2)(a)(1) provides as follows:

Until the death of [Taxpayer], the trustee shall pay the income of [Residuary Trust] to or for [Taxpayer]. Such right of withdrawal shall be exercised by [Taxpayer] notifying the trustee in writing to that effect, specifying the cash or assets at current market value which [Taxpayer] wishes to withdraw; and promptly thereafter the trustee shall make such distribution to [Taxpayer]. Such right of withdrawal shall be noncumulative and shall lapse with respect to each calendar year to the extent that it is not exercised during said calendar year.

Article IV, paragraph (2)(a)(2) provides that upon the death of Taxpayer, the trustee shall pay to Individual 1 a sum of \$a and the balance of Residuary Trust shall be divided equally into separate shares for Individual 2, Individual 3, and Individual 4.

Article VII provides, in relevant part, that Decedent and Taxpayer are appointed as co-trustees. Upon the death, incapacity, resignation or discharge of Decedent or Taxpayer, then Bank shall be the successor co-trustee. In the event Taxpayer dies prior to the termination of Trust, Individual 5 shall be successor co-trustee.

Decedent died on Date 2. Taxpayer was the beneficiary of certain outright bequests from Decedent. The remainder of Decedent's estate was transferred into

Residuary Trust, pursuant to the provisions of Trust. The marital trust was not funded. Decedent's executor, Taxpayer, did not timely file a United States Estate (and Generation-Skipping Transfer) Tax Return, Form 706, to report the transfer and, thereby, did not affirmatively allocate Decedent's GST exemption to the transfer to Residuary Trust.

Attorney, an attorney who was retained by Decedent for the purpose of preparing Trust, states that he made a scrivener's error in Article IV, paragraph (2)(a)(1). Attorney represents that Decedent intended that Residuary Trust would be utilized to provide income for Taxpayer and provide principal to Taxpayer based upon an ascertainable standard for the remainder of Taxpayer's lifetime, and that Residuary Trust would not be included in Taxpayer's gross estate.

In order to correct the scrivener's error in Trust, the trustee of Residuary Trust filed a petition with Court seeking authorization to reform and modify Trust. On Date 3, Court issued an order reforming Trust, effective retroactively as of Date 1. Article IV, paragraph (2)(a)(1) is reformed to provide as follows:

Until the death of [Taxpayer], the trustee shall pay the income of [Residuary Trust] to or for [Taxpayer], and to the extent not sufficient, so much of the principal, at such times and in such manner as the trustee may deem advisable in the trustee's discretion, for the support in her accustomed manner of living, education, maintenance in health and reasonable comfort. In addition, [Taxpayer] shall have the right to withdraw from principal property not exceeding \$5,000 in the aggregate for the year, and, if [Taxpayer] is living on the last day of the year, to withdraw property having a value on that day equal to an amount, if any, by which five percent of the then market value of the principal exceeds the value of the property previously withdrawn by [Taxpayer] for such year. Such right of withdrawal shall be exercised by [Taxpayer] notifying the trustee in writing to that effect, specifying the cash or assets at current market value which [Taxpayer] wishes to withdraw; and promptly thereafter the trustee shall make such distribution to [Taxpayer]. Such right of withdrawal shall be noncumulative and shall lapse with respect to each calendar year to the extent that it is not exercised during said calendar year.

Court's Date 3 order also modified the trustee succession provisions of Trust. Article VII is modified to provide that upon the death, incapacity, resignation or discharge of Decedent or Taxpayer, then the remaining co-trustee is to continue to serve singly. Upon the death, incapacity, resignation or discharge of both Decedent and Taxpayer, Individual 5 shall be successor trustee. Upon the death, incapacity, resignation or discharge of Decedent, Taxpayer, and Individual 5, Bank (or its corporate successor) is to be the final successor trustee.

It is represented that, at the time of Decedent's death, Decedent had \$2 million of available GST exemption and that the value of the assets transferred to Residuary Trust was \$b, an amount less than \$2 million. Taxpayer, as executor of Decedent's estate, filed Decedent's Form 706, on Date 4 to report the automatic allocation of Decedent's GST exemption to Residuary Trust.

You have requested the following rulings:

1. Residuary Trust, as reformed and modified, does not provide Taxpayer with a general power of appointment over the assets of Residuary Trust, and upon the death of Taxpayer, the assets of Residuary Trust will not be includible in Taxpayer's gross estate under § 2041 of the Internal Revenue Code.
2. The reformation and modification of Residuary Trust does not cause the assets of Residuary Trust to be includible in Taxpayer's estate under § 2036.
3. The reformation and modification of Residuary Trust does not constitute the exercise or release of a general power of appointment by Taxpayer resulting in a gift under § 2514.
4. As a result of the reformation and modification of Residuary Trust, Decedent will be considered the transferor, as defined in § 26.2652-1(a) of the Generation-Skipping Transfer Tax Regulations, of the assets in Residuary Trust for GST tax purposes.
5. As a result of the reformation and modification of Residuary Trust, Residuary Trust has an inclusion ratio, as defined in § 2642(a), of zero pursuant to the GST exemption automatic allocation rule of § 2632(e)(1)(B).

LAW AND ANALYSIS

Rulings 1 - 3

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2036(a) provides, generally, that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise,

under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death: (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2041(a)(2) provides that to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) provides, in relevant part, that for purposes of § 2041(a), the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts: (A) \$5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

Section 2501(a)(1) provides, generally, that a tax is imposed for each calendar year on the transfer of property by gift by any individual, resident or nonresident. Section 2511(a) provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that for purposes of § 2514, the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

Section 2514(e) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The rule of the preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of the following amounts: (1) \$5,000, or (2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

State Statute provides that upon application of a settlor or any interested person, the court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor's intent if it is proved by clear and convincing evidence that both the accomplishment of the settlor's intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement. In determining the settlor's original intent, the court may consider evidence relevant to the settlor's intent even though the evidence contradicts the apparent plain meaning of the trust instrument.

In this case, an examination of the relevant trust instruments, affidavits, and representations of the parties indicate that the original terms of paragraph (2)(a)(1) of Article IV, resulting from scrivener's error, were contrary to the intent of Decedent. The purpose of the reformation is to correct the scrivener's error, not to alter or modify the trust instrument. Accordingly, based on the facts presented and the representations made, we conclude that the reformation and modification of Residuary Trust does not provide Taxpayer with a general power of appointment over the assets of Residuary Trust. The reformation and modification of Residuary Trust does not constitute a gift under § 2514 and upon the death of Taxpayer, the assets of Residuary Trust will not be includible in Taxpayer's gross estate under § 2041 or § 2036.

Rulings 4 and 5

Section 2601 imposes a tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means, with respect to any GST, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the "applicable fraction." The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator of which is the value of the property transferred to the trust or involved in the direct skip.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption amount which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a) provides that any allocation by an individual of his or her GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed. Section 2632(e)(1) provides that, in general, any portion of an individual's GST exemption that has not been allocated within the time prescribed by § 2632(a) is deemed to be allocated as follows: (A) first, to property that is the subject of a direct skip occurring at such individual's death, and (B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

Section 26.2632-1(d)(2) provides that a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date. The automatic allocation occurs whether or not a return is actually required to be filed. Unused exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for estate tax purposes (the chapter 11 value), first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.

Under § 2652(a)(1), for purposes of chapter 13, the term "transferor" means the decedent, in the case of any property subject to tax imposed by chapter 11 and, the donor, in the case of any property subject to tax imposed by chapter 12.

Section 26.2652-1(a)(1) provides that the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13.

Based on the facts submitted and the representations made, we conclude that, as a result of the reformation and modification of Residuary Trust, Decedent will be considered the transferor of Residuary Trust for GST purposes. Based upon the representation that Decedent had \$2 million GST exemption available on the date of his death, then pursuant to the automatic allocation rules of § 26.2632-1(d)(2), Decedent's GST exemption was automatically allocated to Residuary Trust. To the extent the date of death value, as finally determined, of the assets transferred to Residuary Trust, does not exceed \$2 million, Residuary Trust will have a zero inclusion ratio.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

The rulings in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for § 6110 purposes
Copy of this letter

cc: